Oral statement of Peter Jenkins

Managing Director

Scudder, Stevens &Clark

Before The Subcommittee on Finance & Hazardous Materials

on

Decimal Pricing
The Common Cents Stock Pricing Act of 1997

April 10, 1997

I. Introduction

My name is Peter Jenkins. I am a managing director at Scudder Stevens & Clark in charge of Global Equity Trading. Scudder Stevens & Clark is a global investment manager with approximately $115 billion dollars under management. Scudder's client base consists of mutual funds. pension funds, and private investment clients. Scudders Global Equity trading group is located in New York City and is active 24 hours a day. 365 days a year. My expertise is in U.S. equities. I actively trade listed and NASDAQ securities, both large and small capitalized issues.

I accepted this invitation to testify on decimal pricing before this sub-committee because I support open. efficient, transparent markets in the United States. Scudder encourages all of its traders to participate in industry-wide forums that address issues that may impact our clients performance.

Our mutual funds represent hundreds of thousands of individual, retail investors. Our client orders can range from 1 to millions of shares. Last year Scudder's client's paid over $100 million dollars in commissions, OTC credits, and selling concessions globally. Our clients generated over $1 million in commissions from orders under five thousand shares. (At a rate of under .03 per share) Our small order flow in NASDAQ issues generated approximately $700.000 in commission credits.

Scudder compensates their traders on the quality of trades not on the quantity **of trades.** It is in the best interest of all traders to receive the lowest cost of execution. Efficient, transparent market structure is essential to accomplish this.

Scudder has been actively involved in structural issues through my participation as Chairman of the New York Stock Exchange Institutional Advisory Committee for three years. the New York Stock Exchange market performance committee, and currently as chairman of the STA institutional committee. I am also a member of the NASDAQ Quality of Markets Committee. I am pleased to be here to discuss my views pertaining to the Common Cents Stock Pricing Act of 1997.

My comments will be broken down into two categories. first decimalization as it effects transparency, and second efficiency of market structures and decimaliration.

Transparency- Decimalization

Instinets' success is changing U.S. market structure. It is a case study and a confirmation that "depth of book"' can create greater volumes while offering competition which tightens equity spreads. The price time priority structure. with size displayed. is moving the markets to an order driven price structure. The prices are discovered through anonymous, yet transparent negotiations[2]. The NASD dealer structure still overlays the instinet trading environment. just as the "upstairs" dealer market of the New York Stock Exchange overlays the floor auction. Stock prices can be quoted in fractions as low as 1/64's in the Instinet market. This ability to quote freely in increments less then the primary market interval has been a factor in attracting liquidity from both dealers and institutional participants. The quotations in these small fractions are cumbersome and confusing.

With the new order handling rules in affect quotes in between the spread by dealers must be reflected in the public quote in NASDAQ. This was a good step towards increased transparency. If an order is entered in an ECN in a" variation different from existing SRO parameters." it is rounded up or down to the nearest fraction accepted by the

[1] The STA institutional committee comprised of 20 of the largest institutions in the US comment to the SEC on the "order execution obligations" on the importance of a central limit order book. and further depth of book through ITS in the listed market. see appendix 1.

[2] According to a survey conducted by the STA institutional committee this is one of the key variables to a buyside trader in getting best execution. see appendix 2.

applicable SRO. The rounded prices will be accompanied by an identifier in July of this year. 'This identifier will cause chaos, and will confuse the individual investor without the direct ECN access. If ECNs flourish, investors will not be able to follow all of the ECNs markets and we. as professional traders, may lose some transparency. Posting true prices for the public should be pursued. The fractions of smaller size can become confusing and in a sense affect transparency. Decimalization is the common form of display in pricing portfolios at day end. We get an average price on executions from our brokers to the fourth decimal place. Mutual funds are priced in decimals at day end to the public.

A spread for the dealers can be maintained in decimal form, and in fact it would put it in a language that is easier for all to read. Foreign markets quote stocks in decimals today with a spread sufficient for dealer profitability.

<u>A decimal auoted spread must be accompanied by depth of book.</u> Narrower spreads will come with decimal pricing. The top of the book display, which we receive today will become far less helpful without full disclosure of the specialist book. The institution needs to see where the greatest gathering of orders reside in order to price merchandise efficiently. Why must the specialist book be proprietary if "capital transactions represent a very small portion of trading. The vast majority of NYSE volume is a result of public order meeting public order."[3] The Institutional Traders Advisory Committee to the

---

'Quote from the NYSE fact book 1994, page 5

NYSE that I chaired for three years consistently called for the specialist book to open up to the public. Scudder's view is that the increased transparency will draw order flow to the NYSE specialist book. Instinet growth proved that this concept is correct. If a trader could get closer to the point of purchase, and gain control of the order more order flow would appear.

Efficiency-Decimalization

Today's market environment calls for the institutional trader to move larger quantities of stock in a structure not far different from that of the Seventies. We need greater visual access as well as more efficient executing access to the current structure. The recent Buyside Traders Survey conducted by the STA institutional committee showed that institutional traders seek immediacy in price because they fear their identity ma)- be given up by their agent as it passes through the many intermediaries an order needs to clear to get to the point **of** purchase on the floor of the NYSE.[4] The survey also showed a great desire to control their trading strategy and would not fear trading off the exchange. The majority·of this group use ECNs so that they can control their strategy and price at the level they feel is competitive. Often these trades take place at intervals lower then 1/8.

---

[4] Please see appendix 2 STA Institutional Committee Buyside Survey.

A very popular chart seen sitting on most traders desk is a tabulation of conversions from the popular fractions to decimals. It is very difficult to convert 64ths in a fast trading environment. Pennies are universal and far easier to understand. We trade in a world where precision is essential and efficiency is demanded. Fractions are converted at the end of the day to decimals for portfolio pricing. This conversion carries a cost which is a step in the traders process that can be eliminated. The most viable solution seems to be conversion to decimals. The reporting we exchange between broker and trader may seem small. but it adds another step in our process. In the future reporting of transactions are going to move between broker and customer via electronics. I would guess that those reports will be in decimals, not fractions.

The exchanges want to study the impact of this move. I think the evidence is clear. Institutions want to trade at fractions lower then currently allowed by the exchanges. There is a desire to discover price yet the market is not structured properly to get the job done. Electronics are changing market structure. Why are we reluctant to make change? The evidence is overwhelming that the current structure needs modifications. Institutions, because of size of the orders, are creating price. The capital supplied by the brokers has become less important as we seek liquidity. Brokers can still be agents to the non members, but we must use the technology offered to enhance the process. Trading should not be cumbersome. if **we** are to provide liquidity to the individual investor. Trading costs will make it prohibitive to move blocks of stock and the costs for capital

---

'Please see appendix 3, which displays a chart most buyside traders have available to them to convert fractions quickly while trading.

formation will increase. Lets keep up with the technological advances and make the transaction process more efficient.

Conclusion

The primary reasons for decimals on our exchanges would be

- Stocks today are actively traded in prices. entered in ECNs, in variations different from existing SRO parameters. ECNs have been linked into the primary markets through the new SEC order handling rules. Stocks traded in 64ths and 32nds are cumbersome to trade and slows the process down.

- The concept of an asterisk as a warning that a price is different then seen causes confusion. and transparency declines.

- Decimalization is used to price portfolios and post net asset values of mutual funds. Trade reports are input in decimals. The daily process of posting prices to our systems could become more efficient.

- If we move to decimalization we must move to depth of book, as the spreads tighten the top of the book becomes less meaningful.

- All changes to exchanges need not be monumental. Decimalization along with other structural changes can add to greater efficiencies to the trading environment

- Spreads whether quoted in fractions or decimals will be dependent on a stocks liquidity.

Appendix 1

SECURITY TRADERS ASSOCIATION
ONE WORLD TRADE CENTER, SUITE 4511, NEW YORK, NY 10048
(212) 524-0484

January 19, 1996

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.c. 20549

Re: Order Execution Obligations - Proposed Rules
Release No. 34-36310; File No. S7-30-95

Dear Mr. Katz:

The Security Traders Association's Institutional Committee appreciates the opportunity to comment on the Commission's proposed rules concerning the handling and execution of customer orders. Our Committee is comprised of twenty buy-side traders who head the trading desks of some of the largest mutual fund complexes, private investment management firms, and public and corporate pension funds in North America, and our comments will be directed to those aspects of the proposals that particularly impact the trading we carry out for our clients.

Summary of the Committee's Comments

Our Committee believes the most important quality of a market is the ability to interact vith live bids and offers that represent real orders, where size is revealed. Quotes by dealers without size parameters in a non-tranmparent market are less meaningful and serve only as an indication of where a stock could trade. A limit order structure with a central limit order book, or CLOB, is the most fair and orderly basis for price discovery in a transparent market. Dealers do not post narrow quotes in a vacuum -- they will not display quotes without some knowledge of real orders. The presence of a limit order book that is accessible to all market participants would only strengthen dealer markets because the dealers would have the ability to gauge market depth in a consistent manner, and hence tighten the published spread. At the same time, we oppose the proposed rule regarding price improvement for market orders at the expense of limit orders, as we believe limit orders provide more transparency and depth to the marketplace.

The Commission has expressed concern that orders in electronic trading systems are not accessible to individual investors and that such systems create a tiered market. Our Committee believes that if, however, the Consolidated Quote System ("CQS") and the Intermarket Trading System ("ITS") were to be extended to *include* orders that appear in electronic trading systems both exchange-sponsored, selective, and private, the linkage of markets that was discussed by the Commission in its Market 2000 Report would be greatly enhanced.[1] These orders ❑ hould be shown as part of the consolidated quote if they better the current published "public"

---

[1]Similar discussion occurred in the GAO's March 1990 report "Securities Trading, SEC Action Needed to Address National Market System Issues" indicating "the need for SEC to again look et overall effectiveness and the *extent to* which it is meeting its national market system goals."

National Best Did and Offer("NBBO") without the obligation of making a two-sided market. In fact, all limit orders should be accommodated by the ITS so that the depth of the market can be determined. The orders would not need to be identified by broker or dealer name since they arm firm commitments to trade at a specified price and quantity, not an indication or quoted market. Spreads would be tightened as this intermarket/broker linkage would expose additional orders to the market at large and all forms of market participants would be forced to compete. In fact other orders that would not have chosen to interact with the larger marketplace might part icipate -- anonymity affords protection co all market participants. The retail investor would not be excluded from accessing thie expanded order flow. A more detailed discussion of these issues follows.

Institutional Orders

The client base of the firma represented on our Committee is comprised of many million6 of individual Investors, both those who invest in mutual funds as well as those who invest pension assets. Individual investors have decided that it is in their best interest to hire professional managers to access the market for them. Accordingly, as buy-aide traders we have a fiduciary obligation to our clients to get chc beet possible execution in handling their orders. The sheer magnitude of individuals acting in concert through our respective firms makes the orders generated the largest, most significant factor in the equity marketplace.

Because thie pool of investors has grown so large, institutional positions in individual securities have grown commensurately in size. While multiple hundred-thousand-share positions were common ten years ago, multiple million-ehara positions are now the norm.[2] The growth in position size has resulted in a far more complex buy-side trading environment; a five million share order will potentially have a much greater market impact than a 50,000 share order even if it is perfectly handled. Our fiduciary obligation to obtain bear. execution is not defined solely by getting the beat price; accessing the depth of the market is a critical component given the size of institutional orders. Maintaining anonymity is especially critical if the buy-side trader is to minimize the market impact of an order.

Use of Broker Capital and Information Plow

Institutional position size ham also changed the way institutions use broker capital. Capital available to the buy-side on brokers' block desks is simply not sufficient to meaningfully accommodate those orders given the increase in the size of institutional orders.' In fact, asking a broker to deploy capital

---

[2]As of 9/30/95, of the 20 largest capitalization stocks in the S & P 500, institutions owned almost 50% of the shares outstanding. with the top five holders of each stock having an average position sire ranging from six million to more than 43 million shares.

[3]Brokers use capital a6 a tool to capture institutional order flow. Broker capital does increase short-term liquidity but the true market always reverts to institutional buy versus sell orders.

to facilitate a trade can impede beet execution. Often, "capital facilitation" works ironically to create an adversary simply because "capital creates a competitor.*

The broker may not only be working against the institution's order flow, but can make an educated guess, by checking the institution's SEC filings, what the potential order size may be. For example. a broker can often correctly surmise that a sale of two million eharee might ultimately be six million sharee. if the filings show that the investment manager owns six million shares and had purchased additional shares in the prior quarter.4 The hope is that the broker acts instead as your agent and finds the natural other side of the trade. That natural other side will most often be another institution and not the broker's capital.

Buy-side traders also recognize that while immediacy is desirable to some. it comae at a price .if that immediacy is provided in the form of broker capital. The buy-side use of systems to access immediacy and maintain more control of order flow is creating a change in market structure. The demand for the use of electronic trading systems (especially Instinet for OTC trades) hae evolved precisely because of the need for inatitutions to anonymously interact in a centralized transparent market structure.

---

[4]Brokers may use this information to get long or short ahead of thair customers' orders, in effect trading ahead of a potential order. They can set themselves up to "facilitate" an order their customer has yet to give them. This can and often does negatively effect the price our clients receive.

The so-called "SOES activists" do something similar on a smaller scale: they seek to capitalize on institutional order impact, profiting as the institutional order effects price. Both strategies increase volatility.

In addition, order-driven systems (e.g., Instinet, SelectNet) have become the markets of choice for the broker/dealer community.

Unfortunately, NASDAQ has not moved to create such a public structure in response to the competition afforded by technological innovation. Even the NAqcess system, ae proposed, falls short of creating the market structure of choice for institutions. We recognize that NAqcess is not 'proposed as an answer to institutional liquidity and transparency, but it has the beginnings of a system that could be expanded to embrace institutional needs in conjunction with those of individual investors. Instinet is such a system -- natural orders are permitted to interact on a price and time priority basis. Price discovery, dynamically changing supply and demand schedules, and the depth of the market are traditional broker/dealer functions anonymously carried out there .

Anonymi ty

The need of buy-side traders to achieve best execution has driven the explosive growth of electronic trading networks. These systems allow institutional traders to seek out and find anonymously the natural other side of a trade and. thua, frequently trade between ehe published best bid and offer. Electronic trading systems such as Instinet greatly add to liquidity and lessen market impact because the identity of participants in a trade arc not revealed. In fact, the institutional community felt that access to electronic trading Systems was so important it coordinated an effort to induce NASDAQ to allow access to SelectNet, a private market run by NASDAQ that ie accessible only to dealere. View-only institutional access was finally granted after a long delay.[5] [6]

Broker/dealers who act as market makers also use such systems, They, too, rely greatly on the anonymity the networks provide. They are able to interact directly and discretely with market participants, and square their books without significantly adding to market volatility.

Amendments to the Quote Rule and Display of Customer Limit Orders

The Committee agrees with the Commission that markets should be as transparent as possible, and that fragmented quotes deter natural price discovery. However, we are not in favor of the proposed amendments to the Quota Rule. A market maker may be forced to change hie published quote to reflect a better anonymous limit order placed in a system such as Instinet. Because of the loss of anonymity thoae orders may never appear in the electronic system. This will impede transparency, as these orders would be forced "upstairs" or perhaps overseas and would not interact with the greatest number of public orders, especially those placed by buy-side traders. Without the ability to interact anonymously with the greatest concentration of live orders, not quotes, price discovery is compromised and liquidity is curtailed.

---

[5]NASDAQ Sub-Committee, 1989 initial diacuasianoninstitutional access to SelectNet.

[6]<u>Market 2000</u>, Transparency. Study IV, pg. 6.

We would also like to distinguish between orders and quotes. especially in light of changes in the marketplace and the presence of electronic systems. Price discovery in the dealer market was controlled by market makers who published their two-sided market based upon their own order flow and market outlook. Technology has now opened the door to market innovation and the dealer quote has, in many instances, become more a frame of reference based on limit orders published in Instinet.

Price Improvement for Customer Market Orders

The committee believes that limit orders and their public dissemination to all market participants are critical to a marketplace that is transparent and enhances price discovery. We oppose the Commission's proposed rule that would require specialists and market makers to provide customer market orders the opportunity to receive price improvement. Limit orders give the system more transparency and depth. We strongly believe that the desire to display limit ordors must ba encouraged. If a market order is automatically given a "stop" to trade at the NBBO, there is little incentive or benafit to enter a limit order into the system.

Limit orders, with time and price priority. should have preference over market orders. A strong limit order book creates market depth.' In fact, preferenced market orders can have a

'Beginning in June of 1989, during the respective chairing of the NYSE's Institutional Traders Advisory Committee ("ITAC") by Holly Stark and Peter Jenkins, a prevailing desire to get an indisruptive effect on the market, as evidenced by NASDAQ's SOES system.[8] [9] In addition, under the currant NASDAQ structure we doubt that systems could be implemented on a timely basis to support this type of change without severe ramificationa. In times of market stress, NASDAQ's systems have thus far proved to be leas reliable than hoped for.

Competitive and innovative ideas have created change in today's marketplace. The explosive growth in technology, especially on trading deake, ha6 allowed for faster flows of information that have resulted in the evolution of market structure. At the same time, the traditional exchanges hove been forced to compete to defend their market shares.

Competition rich the traditional exchanges is healthy and should not be deterred. But rules governing trading must be consistently enforced as well as altered on a timely haeis when the marketplace refuses to meet the changing demands of its customers. Most importantly. structural changes should only be put in place on a trial basis before making them permanent.

The Committee would like to thank the Commission for the

---

depth "look at the book" was communicated to the Exchange. It was felt that this would attract more limit orders to the floor of the Exchange.

'See attached Committee letter, June 21, 1995, to the NASD discussing NAqcess and the benefits of a limit order book.

[9]Many Committee members believe in fact that the NYSE's "clean cross* rule is non-competitive, in that it works against the standing of limit orders. While we as institutions benefit from this rula, it does not encourage limit order entry.

opportunity to comment on these proposed changes. We would be happy to further discuss the proposals should you so choose.

sincerely,

Peter W. Jenkins,
Chairman

Holly A. Stark,
Vice Chairman

Appendix 2

STA INSTITUTIONAL COMMITTEE

Buyside Trading Survey:

What if it Were Your Market

Instead of the Brokers?

STA INSTITUTIONAL COMMITTEE
Buyside Trading Survey:
What if it Were Your Market Instead of the Brokers?

Please respond to the following questions by circling the response that best reflects how you would prefer to trade:

The following questions deal with immediacy in trading:

1. How important is immediacy in trading?

(5) Very Important	(4)	(3) Somewhat Important	(2)	(1) Not Important At All
87	35	38	5	3

94.7%

72.2%

2. Concerns about trading behavior:

I'm afraid my broker will compete with my order.

(5) Strongly Agree	(4)	(3) Agree Somewhat	(2)	(1) Strongly Disagree
15	32	68	35	15

27.8%

69%

mean 2.97

I'm afraid my broker will call competing brokers.

(5)	(4)	(3)	(2)	(1)
21	32	48	48	18

31.4%

59.8%

mean 2.94

I'm afraid my broker will call customers who will call other brokers.

(5)	(4)	(3)	(2)	(1)
34	51	45	25	12

50.3%

76.9%

mean 3.42

Sometimes my broker calls me back with my own order.

(5)	(4)	(3)	(2)	(1)
10	13	40	53	46

13.6%

37.3%

mean 2.31

STA INSTITUTIONAL COMMITTEE
Buyside Trading Survey:
What if it Were Your Market Instead of the Brokers?

3. If 5 years ago the starting order entered by your portfolio manager was 50,000 shares, is your order today:

mean: 222,000

(5)	(4)	(3)	(2)	(1)
50,000	100,000	150,000	250,000	500,000
17	27	38	54	27

median: 149,000

4. If 5 years ago a broker was willing to commit capital and start you out on 50,000 shares, what would he start you out on today?

A, For NASDAQ stocks:

mean: 39,000

(5)	(4)	(3)	(2)	(1)
15,000	25,000	50,000	100,000	250,000
44	48	37	18	1

median: 21,000

NYSE

B. For listed stocks:

mean: 68,000

(5)	(4)	(3)	(2)	(1)
15,000	25,000	50,000	100,000	250,666
9	41	48	46	9

med: 39,000

5. If you could lower the market impact cost of a trade by a meaningful amount based on the stock's liquidity, would you be willing to forgo immediacy?

(5)	(4)	(3)	(2)	(1)
Strongly Agree		Somewhat Agree		Strongly Disagree
64	35	58	9	2

58.62

92.9%

STA INSTITUTIONAL COMMITTEE
Buyside Trading Survey:
What if it Were Your Market Instead of the Brokers?

6. How important is it for you to control the strategy of your execution?

(5) Very Important	(4)	(3) Somewhat Important	(2)	(1) Not Important At All
120	37	12	0	0

92.9%

100% !

7. How important is it to know, when you enter your buy or sell order, if the broker has a long or short position in the stock for his own account?

(5) Very Important	(4)	(3) Somewhat Important	(2)	(1) Not Important At All
108	32	25	2	1

82.8%

97.6%

8. If my broker is positioned with me, that Is, he has committed capital for me, he won't compete with me.

(5) Strongly Agree	(4)	(3) Somewhat Agree	(2)	(1) Strongly Disagree
14	21	50	52	28

20.7%

50.3%

STA INSTITUTIONAL COMMITTEE
Buyside Trading Survey:
What if it Were Your Market Instead of the Brokers?

The follo wing questions deaf with anonymity:

9. When you trade, how important is keeping your identity anonymous?

(5) Very Important	(4)	(3) Somewhat Important	(2)	(1) Not Important At All
136	16	10	3	0

89.9%

95.7%

IO. How concerned are you about Information leakage after contacting a broker?

(5) Very Concerned	(4)	(3) Somewhat Concerned	(2)	(1) Not Concerned At All
87	38	28	7	5

74.0%

90.6%

11. Has a broker ever revealed to you the customer on the other side of a trade?

(5) Frequently	(4)	(3) Occasionally	(2)	(1) Never
2	8	63	49	41

5.9%

43.2%

STA INSTITUTIONAL COMMITTEE
Buyside Trading Survey:
What if it Were Your Market Instead of the Brokers?

The follo wing questions deal with trading methodologies:

12. How important is it for You to trade on the primary exchange where a stock is listed?

(5) Very Important	(4)	(3) Somewhat Important	(2)	(1) Not Important At All
20	4 5	53	15	32

38.5%
27.8%
mean 3.04
69.9%
59.2%

13. How important is the quote on the primary exchange as a parameter when you are trying to determine at what price to trade?

(5) Very Important	(4)	(3) Somewhat Important	(2)	(1) Not Important At All
88	45	29	1	0

79.3%
96.5%

14. Do you use electronic communications networks (ECN's), i.e., Instinet, Posit, in your trading?

(5) Frequently	(4)	(3) Occasionally	(2)	(1) Never
84	14	34	10	22

58.0%
78.1%
18.9%
mean 3.78

STA INSTITUTIONAL COMMITTEE
Buyside Trading Survey:
What if it Were Your Market instead of the Brokers?

The following questions deal with market transparency:

15. To determine the best price at which to trade, how important is it to see the size of bids and offers at various price points?

(5) Very important	(4)	(3) Somewhat important	(2)	(1) Not Important At All
117	30	17	1	0

87.0%

97.8%

mean 4.59

16. Do brokers provide more liquidity in markets where there is more exposure of quotes and size? For example, if the market is quoted 50,000 up with a 1/8 point spread, my broker's upstairs market would be 150,000 around an 1/8.

(5) Strongly Agree	(4)	(3) Somewhat Agree	(2)	(1) Strongly Disagree
52	47	55	4	3

58.6%

91.1%

17. If you were bidding for a stock and someone else appeared, should you have to share prints with others who showed up later and matched your bid?

(5) Strongly Agree	(4)	(3) Somewhat Agree	(2)	(1) Strongly Disagree
25	37	65	16	20

36.7%

75.2%

mean 3.19

18. When I think someone is leaning on my order, I would like the ability to cancel the order from the market without calling the broker.

(5) Strongly Agree	(4)	(3) Somewhat Agree	(2)	(1) Strongly Disagree
18	21	42	34	36

25.8%

53.6%

mean 2.68

Appendix 3

HILL

1/64	.015625	33/64	.515625
1/32	.03125	17/32	.53125
3/64	.046875	35/64	.546875
1/16	.0625	9/16	.5625
5/64	.078125	37/64	.578125
3/32	.09375	19/32	.59375
7/64	.109375	39/64	.609375
1/8	.125	5/8	.625
9/64	.140625	41/64	.640625
5/32	.15625	21/32	.65625
11/64	.171875	43/64	.671875
3/16	.1875	11/16	.6875
13/64	.203125	45/64	.703125
7/32	.21875	23/32	.71875
15/64	.234375	47/64	.734375
1/4	.25	3/4	.75
17/64	.265625	49/64	.765625
9/32	.28125	25/32	.78125
19/64	.296875	51/64	.796875
5/16	.3125	13/16	.8125
21/64	.328125	53/64	.828125
11/32	.34375	27/32	.84375
23/64	.359375	55/64	.859375
3/8	.375	7/8	.875
25/64	.390625	57/64	.890625
13/32	.40625	29/32	.90625
27/64	.421675	59/64	.921875
7/16	.4375	15/16	.9375
29/64	.453125	61/64	.953125
15/32	.46875	31/32	.96875
31/64	.484375	63/64	.984375
1/2	.5	1	1.00

TRADING NEW YORK 800-631-3083
TRADING CHICAGO 800-601-9888
TRADING FLORIDA 800-450-2566

Hill Thompson
Magid

THE REAL Institutional AGENDA

by John A. Byrne

Transparency. Spreads. Hidden Limit Orders...

The SEC is Listening.

Some people hate Arthur Levitt. But don't include Peter Jenkins and Holly Stark, the chairperson and vice-chairperson respectively of the Security Traders Association's Institutional Committee.

Jenkins and Stark see Levitt leading change – a distinctly unpleasant business in the relentless technological evolution of equity trading.

Try telling that to Nasdaq traders. Levitt's zeal to put *new order handling rules in place by early January*, is viewed with trepidation, confusion and blood-curdling hostility.

The Securities and Exchange Commission chairman said the new rules will help tighten spreads, and provide limit order protection on retail size trades. Nasdaq traders said the rules will soak up liquidity like a giant sponge, and force some dealers out of business.

But Jenkins and Stark beg to differ. They belong to the buyside.

Nasdaq desks, on the sellside, see Levitt on another mission, albeit a mission to shift the deal system into a quasi-auction business. The barking hasn't stopped.

The buyside? Truth to tell, the crusading SEC chairman may have made friends in this close-knit community of traders – a community that packs huge *clout on Wall Street with the multi-million dollar block* orders it routs to Nasdaq and other exchanges.

Jenkins and Stark are two of their most vocal and powerful leaders, and they may come the closest as any these days uttering what passes as sweet music to the ears of Arthur Levitt.

They lead a 21-person group representing a swathe of the largest mutual fund complexes, private investment firms and public and corporate pension funds in North America.

Sure, the SEC chairman is no poster boy of the buyside. But neither is he a pariah.

The SEC order handling rules? Jenkins and Stark don't bat an eyelid.

"We were pleasantly surprised," said Jenkins, managing director, head of global equity trading at New York-based Scudder, Stevens & Clark. "We were very happy. It was one of our big issues. Don't put in rules that give someone a monopoly. The rules are going to open up competition."

"Driven by technology," Stark interjected.

Jenkins added. "What they are going to do is create a better structure in the market place."

Of course, some of the loudest voices raised against the rules are heard on the sellside. That's because Nasdaq traders are concerned that the art and science of market making may be a tough act to follow once the new SEC rules take effect January 10.

At the Security Traders Association annual conference in Orlando this year, E.E. "Buzzy" Geduld, president of Herzog, Heine Geduld, summed up the frustration at a 7 a.m. workshop.

"The big [market makers] will get bigger and the small will go away, and I think ultimately someone is going to have to pay," he said. "Nobody is going to sit there all day when 30 percent to 40 percent of the orders are limit orders. How can someone stay in business, buy at 10, sell at 10, when you pay clearing costs?"

That's fundamental change.

Stark, senior vice president, Dalton, Greiner, Hartman, Maher & Co., in New York, said Wall Street

Turning Up The Heat On The New York Stock Exchange *Could* This Be *Hanky-Panky...*?

Nasdaq market makers may be **singing** the **blues over** the SEC's **order** handling **rules.** But spare a **thought for** the **specialists on** the **floor** of the New York **Stock** Exchange.

That's because the **rules** will **require** them to display **customer** limit orders and **size** if **they improve the** inside market.

Some **on Wall Street thought it was all one big over-the-counter** headache.

"A lot look **on** the **rules as** a" **Nasdaq** trading issue," said Peter **Jenkins, chairperson** of the **STA's Institutional Committee.** "Quite **the contrary.** The **rules will** have **an** impact **on** the Big Board."

The issue raises the subject of an 1992 academic study authored by Thomas McInish and Robert Wood that maintained limit orders on the Big Board were not disclosed. The two academics called these undisplayed limit orders that are at better prices than those of limit orders actually displayed, the "hidden limit order book."

Raymond **Pellechia,** an exchange spokesman, told ***Traders Magazine* that** the issue of hidden **limit orders** is redundant. **"The** [study] put out something that **needed to be** addressed **and we responded," he said. "As an issue** n **is not there anymore."**

However, Holly Stark, **vice-chairperson** of the STA **Institutional** Committee raised some doubt. **"The specialists** have **these** [SEC] **rules, saying they are going** to **have** to show **hidden limit orders,** and **adjust their quotes accordingly," she said.**

But she added **that** the **issue is,** "probably **going** to go **away" when the order handling rules** take effect.

Indeed, Stark and Jenkins said a new day may **be dawning on** the **floor** of **the Big Board.**

Will there be **more** transparency, as a **result of the** SEC **rules** ? **"Absolutely,"** Stark said.

Will spreads tighten on **NYSE-listed** stocks "Sure, that's possible," she **responded.**

Of course, transparency is the **Institutional Committee's mantra.**

The **Big** Board **said** the exchange is **"still** in the **process** of **reviewing** and **evaluating** any **changes** that may be **needed" as** a result **of the rules.**

Institutional buyside firms became **frustrated** with the **five** step **it generally takes before an institutional order hits the specialist's book.**

Here's the **gripe:** The **institution** tells **its** trader about the **order.** The trader contacts a **position trader on** a **dealer's** desk. The **position** trader **contacts** the clerk **on** the exchange **floor. The clerk** then **contacts the floor** broker, **who** in **turn goes over** to the **specialist** to **work the** order.

Wheew! Sometimes that's the reaction **among institutions** in **this** era of **high-tech gizmos. "Instinet** has afforded us a lot of transparency, **especially on Nasdaq** stock," **Jenkins said. "But we** don't have that **kind** of ability to **anonymously assess** or **gauge liquidity in listed** stocks."

Added **Stark, "It's** a **time-consuming process** and **there** is a huge **potential for leakage** of **your indication** all along **the** way."

The **Big** Board **specialists are** MM to have **consultants looking** at **the thorny** issue. **The Institutional Committee said** it would be pleased to **contribute** its **views** to the consultants. -John A. **Byrne**

The Buy-Side Brigade

The successful heave by institutional firms, to force the NASD to allow them to view Nasdaq's SelectNet book, helped galvanize the political muscle of STA's Institutional Committee. The SEC took note.

About two years ago, the committee invited SEC chairman Arthur Levitt to meet with members. Levitt came to New York and the meeting ranged over issues of market structure.

"It showed we were getting the ear of some of the most important people in the industry," committee chairperson Peter Jenkins said.

The STA took note. The association three years ago encouraged institutional buy-side firms to organize a committee, representative of a cross-section of the industry. This led to the formation cd what some have dubbed the "new" institutional committee. It effectively replaced a committee that some said didn't seriously reflect the institutional view.

Jenkins himself is as smart as they come in pushing the institutional agenda. He is a past chairman of the New York Stock Exchange's Institutional Trading Advissory Committee (ITAC).

Herewith, the other 20 members cd the institutional committee, as of end of October:

- Holly Stark, (vice-chairperson), Dalton, Greiner, Hartman, Maher & Co.
- Ron Stein, AIM Capital
- Dan Panker, Alliance Capital
- Steve O'Neill, ARCO Investment
- Fred Hughes, Capital Guardian
- Paul Harvey, Brinson Partners
- Bill Perry, Fidelity Investments
- Damian Maroun, General Electric Investments
- Don Fredell, IDS Financial Services
- Rick Holway, Investment Advisers
- Harold Bradley, Investors Research Corp.
- David Butler, Kemper Financial Services
- Charlie Simon, Lazard Asset Management
- Michael Murphy, Morgan Grenfell Capital
- Barbara McFadden, Peregrine Capital
- Tom Hearndon, Strong Capital Management
- Andy Brooks, T. Rowe Price
- Terry Goodwin, UBS
- Gail Kummer, Winslow Capital
- Mary McDermott-Holland, Franklin Portfolio Investors

has a long history of resisting change.

"Change is anathema to human beings," she added. "People don't like change."

Flashback to the ending of fixed commissions in 1975. "People said it would be the deathnell of the stock market and firms were going to loose money. What happened? Quite the contrary. It changed the players, volume has grown."

Turbulence is an understatement.

At another early morning workshop in Orlando over heaped platefuls of scrambled eggs and bacon and other cholesterol-soaked necessities, Richard Lindsey, the SEC's director of market regulation was less than subtle.

Lindsey said the SEC expects some market makers to quit. "Clearly, there will be some entry and exit," he said. The words were enough to spoil a hearty breakfast.

SEC's Lindsey said the agency expects some market makers to quit trading.

If there are winners, the bet is that institutions will reap the awards as much as the so-called small investor. Of course, the mythical small investor from spudgrowing country can't be separated from the buttoned-down world of institutional investment. Capital pouring into mutual funds and pension plans represent the incomes of those investors.

"We truly feel we represent a substantial portion of retail investors," Jenkins said.

Consider: retail customers have been promised limit order protection on orders up to 10,000 shares or on orders valued at no more than $200,000. But that share size is not unusual for institutions working and negotiating huge block trades. Typically, Buy-side institutions are accumulating their positions in trade sizes ranging from 300 shares up to 25,000 shares.

"The SEC rules are not going to negatively impact us," Jenkins said. "They are in fact, very beneficial to us."

Though buyside traders might seem odd bedfellows for a trade group strongly identified with over-the-counter trading, there is a dynamic at work that inextricably links their destiny – the exponential growth in the equities markets.

The point is not lost on Jenkins. The committee's annual "Institutional Tuesday" panel at the STA conference, aims to "stir the crowd" – buyside and sellside. "Our message this year was, change the market structure for what everybody wants," he said.

That growth has lead to some stark changes in the complex relationship that binds the interests of the buyside and sellside. Positions of 100,000 shares that set records ten years ago, take multi-million share sizes today. And these orders have potentially much greater impact than the 100,000 shares orders in 1986.

"Our orders are huge, "said Jenkins, stressing the word huge. "So you say big deal, what does it mean?"

For one thing, the institutional committee believes that dealers capital commitment hasn't kept pace with the increased sizes of block business. "Some would say the size of capital commitment has even decreased," added Jenkins.

The institutional committee conducted a survey of institutional firms to determine the level of that capital commitment. If dealers bid them 50,000 shares on a particular Nasdaq trade five years ago, what typically would the bid be on the same trade today? Jenkins said that most of the answers came back lower – at 15,000 and 25,000 share sizes.

"Our point is that the market structure has changed, and we want a say in it. We are the factors in pricing securities. It is not the capital on the dealer side that is pricing all the merchandise, especially the largest pieces of merchandise," Jenkins said.

The committee makes no bones about one of its cherished goals – transparency, a titanic word meaning access and openness on stock prices and market depth. Three years ago, Jenkins helped lead a heave that eventually allowed institutions have access to quotes broadcast on SelectNet. SelectNet enables market makers to negotiate trades electronically among themselves, instead of by phone.

Previously, the SelectNet "book" was restricted to Nasdaq market makers, giving them an unfair advantage, according to institutions.

Today, on the eve of seismic shifts in market structure, Jenkins and Stark are worried again.

The cause is NAqcess, the NASD's proposed alternative for the Small Order Execution System and SelectNet. NAqcess may ultimately be the facility for displaying unmatched limit orders if they raise the inside prices. That would relieve market makers of that requirement under the order handling rules.

Somewhere in the rush to put the SEC's order handling rules into effect, there are industry participants, such as Stark and Jenkins, wishing the NASD would delay NAqcess. At this moment, the NASD seems headed for a Spring launch.

But Jenkins and Stark said NAqcess may not be necessary. "Let's put the new SEC rules into effect first and see what happens," Stark said.

"That's almost unanimous on the committee," Jenkins said. "We have some problems with NAqcess."

In a strongly-worded letter to the SEC, September 26, the committee said it was "dismayed" that current rules don't allow institutions to view the NAqcess book. "The entire book would only be visible to market makers, and only they would be able to see the depth of the market," the letter stated.

NAqcess would allow institutions view limit orders at the "top of the book," essentially meaning the best bids and offers. But institutions want to gauge the depth of the book. "The NASD argues that that is all the Big Board provides – access to top of the [specialists] book, but we're saying, 'let's be more creative, let's be the first to make change,'" Jenkins said.

Institutions want more than a view of the "top of the book" on NAqcess.

Institutions want a publicly displayed limit order book, accessible to all market participants. "The key is for us to be able to get in and out of the market anonymously," Jenkins said. "That's where there is a little bit of conflict with the dealers."

Back in the pre-Nasdaq era, life seemed simple. The most sophisticated technology on the over-the-counter desk was probably a rotary telephone. There was no interconnected network of computer displaying market makers bids and offers. Today, some industry participants have seized on the advances in Electronic Communications Networks (ECNs), such as Instinet and SelectNet, and other technologies, to push for a new equation in the trading relationship.

In effect, these participants, many of them dealers' customers such as institutions, are daring to challenge the fundamental role of market makers – buyers and sellers of securities at publically quoted prices for their own account and risk. "The ECNs are scaring the sellside a bit," Jenkins said.

The SEC chairman has listened carefully to the STA's Institutional Committee. How carefully' The committee had at least one meeting with Levitt ahead of the approval of the new SEC rules. "He was very surprised at some of our comments." Jenkins said. "We were basically talking about market structure."

Stark and Jenkins didn't elaborate.

The NASD has listened carefully to the committee. Conference calls between rhe committee and NASD officials to hammer out their respective agendas. were nor uncommon the past few years.

The committee would like to think that their pow-wow with Levitt had some impact on the "en rule proposals. "We were very happy we had the communication." Jenkins said, "We were successful in working with the SEC to make sure we were "or negatively impacted by the rules." Stark added.

Stark and Jenkins' chirp)- mood is a striking contrast to the impending sense of doom and gloom hanging over the dealer community.

Institutions want to be heard. "We're an important part of market structure. If you don't do it right – as we discovered with SOES – it can negatively affect that structure," he said.

"Nobody really knows – despite all the conjecture and impact studies – the unintended consequences until they're actually put in place," he added.

The institutional committee didn't want the dealer community controlling the agenda as the SEC shaped up its new rules.

"We don't want to find out before it is too late that, oh my gosh, the rug has been pulled out from under us," Stark said. TM